ZILLOW, INC. Q1 2014 EARNINGS – PREPARED REMARKS
May 7, 2014

Raymond Jones, IRO:

Thank you. Good afternoon and welcome to Zillow's first quarter 2014 earnings conference call. Joining me today to talk about our results are Spencer Rascoff, chief executive officer, and Chad Cohen, chief financial officer.

Before we get started, as a reminder, during the course of this call we will make forward-looking statements regarding future events and the future financial performance of the company. We caution you to consider the important risk factors that could cause the company's actual results to differ materially from those in the forward-looking statements made in the press release and on this conference call. These risk factors are described in our press release and are more fully detailed under the caption "Risk Factors" in Zillow's Annual Report on Form 10-K for the year ended December 31, 2013, and in our other filings with the SEC.

In addition, please note that the date of this conference call is May 7, 2014, and any forward-looking statements that we make today are based on the assumptions as of this date. We undertake no obligation to update these statements as a result of new information or future events.

During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release. In our remarks, the non-GAAP financial measure-adjusted EBITDA will be referred to simply as EBITDA, which excludes share-based compensation.

This call is being broadcast on the Internet, and is available on the Investor Relations section of the Zillow website at investors.zillow.com. A recording of this call will be available after 8 p.m. Eastern time today. Please note that the earnings press release is available on our website, and after the call, a copy of today's prepared remarks along with exhibits of our business metrics will also be available on our website.

Today we will deliver 20 minutes of prepared remarks to start, and then we will host a live question and answer session for 40 minutes. During the Q&A we will entertain questions asked via Twitter and Facebook, in addition to questions from those dialed in to the call. Individuals may submit questions by tweeting @Zillow using the #ZEarnings hashtag, or to the official Zillow Facebook page. After the call, Ron Josey from JMP Securities and Mike Graham from Canaccord Genuity will moderate a 15-minute follow up Q&A session with Spencer via Twitter with the same #ZEarnings hashtag. We are very pleased to welcome Ron and JMP Securities to the Twittersphere. I will now turn the call over to Spencer.

Spencer Rascoff, CEO:

Thank you for joining us today to discuss our first quarter 2014 results.

We had a terrific quarter, ahead of expectations, which flows through to our raised full year outlook that we'll discuss later in the call. Traffic on mobile and Web continued to grow quickly, with more than 50% year-over-year growth in average monthly unique users during the quarter. We reached a new traffic record of nearly 77 million unique users in March, which we just topped with a new record of almost 79 million unique users in April. Both months represented an absolute gain of more than 26 million unique users year-over-year. And mobile continues to represent the majority of our visits, with two-thirds of Zillow visits now coming from a mobile device. Mobile usage nearly doubled from first quarter 2013. And in April, a record of more than 460 million homes were viewed on Zillow mobile, which equates to 178 homes every second. When we went public three years ago, this was about 21 homes per second.

In addition to audience growth, we see positive momentum across our entire business. In the first quarter, we exceeded a record $66 million in revenue, up 70% year over year, and representing the 14th consecutive quarter of above 67% year over year growth. For comparison, we generated $66 million in revenue for all of 2011, just three years ago, when we went public. A key contributor to this growth was our Premier Agent business, which closed the quarter with over $180 million annualized revenue run rate, up from more than $150 million annualized revenue run rate last quarter.

Moving from the top to the bottom line, our adjusted EBITDA approached $9 million for the quarter, higher than expectations due to strong sales. While we increased our strategic investment this year in advertising, the incremental EBITDA indicates the potential for margin expansion in our model longer term.

Overall, we're off to a great start in 2014 as we execute on our three strategic priorities of growing our audience, growing our Premier Agent business, and growing our advancing marketplaces. I'll now touch briefly on progress in all three areas.

Our first priority is audience. We believe that by attracting the largest audience in our category, over the long term, we will win the leading share of revenue and profits. Advertisers follow audience.

Audience starts with product, and we are continuously expanding and improving our "living database of all homes" to provide better data, and better experiences on mobile and Web. Today, we are approaching 50 million homes in our database that have been improved and edited by homeowners and real estate agents. That's nearly half of all homes on Zillow. These user contributions, coupled with continuous additions and improvements of data, are creating the largest and most complete repository of information on U.S. homes, anywhere.

Additionally, we recently crossed two significant milestones for our flagship Zestimate® product, which helps homeowners, buyers and sellers understand the value of homes. First, we made significant improvements nationwide on Zestimate accuracy. Our median margin of error on Zestimates, which we measure by comparing

Zestimates to actual sale prices on individual homes, is now less than 7%[i]. Without ever stepping into a house, we are able to algorithmically estimate a home's value within 7%, which is the best median margin of error we've had in our 8-year history, and the best published accuracy rate of any automated valuation model that exists today. This is a significant analytical feat, a core competency of Zillow's, and a strategic competitive moat.

Secondly, we recently launched Zestimate forecasts on more than 50 million individual homes. This latest data layer predicts a home's value change for the coming 12 months, and is shown on individual home detail pages on mobile and Web. For consumers who are looking to buy a home - and for homeowners who might consider selling their home - the Zestimate forecast, which is only viewable on Zillow, provides yet another reason to use Zillow during their real estate search process.

Complementing the advances in our product, we continue to execute extremely well in marketing, both in our organic and PR efforts, as well as advertising. During the first quarter, we went back on air with TV advertising after being off-air for most of the fourth quarter of 2013. We also added a new layer of product integration into various television shows, including NBC's primetime home renovation show, American Dream Builders, as well as an integration with cult-favorite Portlandia on cable channel IFC, and continued work with HGTV.

We measure the impact of our advertising carefully, and all metrics are showing extremely positive results, which contributed to the record traffic and revenue for the quarter. For competitive reasons, we are not sharing the makeup of our acquisition funnel or specific advertising results, instead letting our business results speak for themselves. We are firing on all cylinders in marketing, and it's having a significant and meaningful impact on our business. We continue to have high confidence in our planned advertising investment in 2014 across channels, and have plans to build on our momentum throughout the spring and summer home shopping season.

Moving now to an update on our second priority of growing our Premier Agent business, we continue to reach new heights on the strength of our product depth and audience growth. At the end of the first quarter, we had nearly 53,000 Premier Agents. In addition, average monthly revenue per agent, or ARPU, was $286, an increase of $27 or 10 percent from a year ago, and a new high for this measure. Another way to look at our ARPU growth among Premier Agents is by comparing same-store-sales. Agents who are subscribers with us for a year or more are spending nearly 50% more on average now than they were a year ago. In fact, an increasing number of existing Premier Agents want to spend more with us to accelerate their business – this quarter, 60% of our new bookings came from existing Premier Agents buying more advertising.

One of the ways we help agents succeed is through our Tech Connect program, where we provide our subscribers the ability to easily connect to the CRM tools of their choice, whether it's Zillow's free CRM, a CRM provided by their brokerage or MLS, or one that they pay for from a technology provider. We now have connected to 15 different CRM platforms, up from 2 launch partners when we first announced the program in November 2013, with a lengthy pipeline of more to come. The beauty of Zillow Tech Connect is that we are technology agnostic here, preferring to provide an open platform and let agents use whatever software they want. We focus on selling them more media impressions rather than trying to shoe-horn and cross-sell them into any specific expensive or legacy CRM.

Turning now to our third strategic priority of growing our advancing marketplaces, we continue to gain traction on each growth path we are taking.

In Mortgages, we are experiencing steady growth and deepening our relationships with our lenders even in the rising rate environment. In Zillow Mortgage Marketplace, consumers have now created nearly 75,000 lender reviews, a strong testament to this marketplace's vibrancy, best-in-class shopping experience, and growing network effect. Our new consumer pre-approval product has been positively received, providing our lenders with more opportunities to serve the millions of home buyers on our site.

In our New York City marketplace, the largest and most important local real estate market in the U.S., our StreetEasy acquisition is performing extremely well. We have added more than a dozen new employees to the talented team of 30 at the time of the acquisition last August, and have already redesigned the StreetEasy website and relaunched it without a paywall. We are now heads down building out the mobile offering and multi-screen experience for StreetEasy. We are building fantastic new products and features that combine Zillow's deep understanding of the consumer and our industry leading mobile expertise with StreetEasy's deep data connection to New York City. We have much to look forward to in New York in the coming months.

In our rentals marketplace, we are very pleased with our progress in monetization. Based on our own goals and historically how we have ramped in other marketplaces, we are ahead of schedule.

To conclude, our terrific results this quarter indicate our strong potential for sustainable long term growth and leadership in the category. As the leader, we continuously attract the most talented personnel to our cause of empowering consumers. In the quarter, we hired over 45 new members in our technology and development teams across our offices - and we welcomed aboard two of the real estate industry's distinguished thought leaders in Errol Samuelson and Curt Beardsley. Our team gets excited about data, and looking at the 2013 U.S. housing market stats, the estimated transaction value for sales of new and existing homes was over $1.4 trillion[ii], leading to approximately $75 billion in commissions paid[iii]. Agents and brokers typically spend 10% to 20% of total commissions on advertising annually[iv] – in addition to the billions of dollars spent on advertising by professionals in mortgage, rental and home improvement[v]. Our market opportunity remains massive and in the early stages of online migration, especially on mobile. The further we pull away now, the better things get, and yet we are still just getting started.

With that I will turn the call over to Chad.

Chad Cohen, CFO:

Thanks Spencer.

I'll start off with our terrific usage growth in the first quarter and then move into operating results. We attracted a record 70.7 million average monthly unique users to Zillow's mobile applications and websites in the first quarter, growing 51% year over year – a four percentage point acceleration over last year's 47% growth rate – on a much larger user base.

Turning to our operating results, total revenue for the first quarter increased 70% year-over-year to a record $66.2 million from $39.0 million in the same quarter last year. Total revenue in the first quarter exceeded the midpoint of our guidance of $62.5 million by $3.7 million, or 6%. We saw a continued shift in our revenue mix as we ended the first quarter with 81% of our revenue coming from our Marketplace category, while 19% came from Display.

Taking a deeper dive into our primary revenue category, Marketplace Revenue grew 72% year-over-year to $53.4 million as we continued to see strong growth across our Real Estate and Mortgage subcategories.

Going further into our Real Estate subcategory, which includes Premier Agent, Diverse Solutions, StreetEasy and Rentals, our revenue accelerated sequentially for the second quarter in a row and grew 77% year over year to reach $46.2 million, compared to $26.1 million last year. Our Premier Agent business continues to execute, and during the quarter we added 4,654 net new Premier Agents, ending the period with 52,968 subscribers. The vast majority of additions were at the platinum level, continuing the trend we've seen throughout the last few years. As Spencer noted, 60% of our new sales bookings in the first quarter went to existing agents purchasing more impressions across mobile and Web, up from 55% in the fourth quarter, which signifies strong underlying demand and positively impacts average monthly revenue per subscriber, or ARPU.

Premier Agent ARPU was a record $286 in the first quarter, which was 10% higher than the figure in the same period last year and 6% higher sequentially. As a reminder, ARPU reflects average contract size and how we price subscriptions in a market. Pricing of our Platinum Premier Agent subscriptions is predicated on local home values, contact liquidity and demand for impressions in a ZIP code.

Moving from real estate to mortgages, which consists of Zillow Mortgage Marketplace and Mortech, revenue reached $7.1 million and grew 45% year over year, which includes a full period of Mortech revenue in the current and prior years. Mortech's contribution was $1.5 million in the quarter this year. In Zillow Mortgage Marketplace, 5.8 million loan requests were submitted during the quarter, growing 29% year over year, with purchase loan requests representing the vast majority of the mix.

Looking at our Display category, revenue in the first quarter grew 62% year over year to $12.9 million, and we achieved our highest first quarter growth rate in display since going public. This represents the third consecutive quarter of robust 50% or greater growth, and is a positive reflection of our sustained audience growth, the efforts of our display sales team, and the value we provide to both endemic and non-endemic advertisers.

Shifting now from revenue to operating costs, total operating expenses were $72.7 million compared to $42.8 million during the first quarter 2013, in line with last year as a percentage of revenue.

I will now talk through the expense line items, comparing the first quarter results this year to last year:

First, our cost of revenue during the quarter was $6.2 million, or 9% of revenue, compared to $4.1 million, or 11% of revenue last year. Favorable leverage resulted from higher growth of our owned and operated mobile apps and websites vs. those of our partners, with whom we have revenue sharing arrangements.

Next, Sales and Marketing expense was $34.9 million, or 53% of revenue, versus $19.8 million last year, which was two percentage points of revenue higher and slightly below our guidance range of $36 to 37 million. Total advertising spend in the first quarter was on plan.

Technology and Development costs in the quarter were $17.0 million, or 26% of revenue, compared to $10.6 million, or 27% of revenue, in the first quarter 2013. The increase in costs reflects higher depreciation and amortization and increased headcount-related expenses year over year.

G&A costs in the first quarter were $14.7 million, or 22% of revenue, as compared to the first quarter 2013 of $8.2 million, at 21% of revenue. The increase in absolute dollars year over year is primarily attributed to higher headcount and services costs, as well as higher facilities costs to support our growth.

GAAP net loss was $6.3 million in the first quarter, compared to $3.7 million in the first quarter 2013. First quarter 2014 basic and diluted loss per share were $0.16, based on 39.3 million weighted average shares outstanding. On a Non-GAAP basis, which excludes share-based compensation, basic and diluted earnings per share were $0.02.

EBITDA for the quarter was $8.7 million, exceeding the midpoint of our EBITDA outlook by $4.5 million and representing 13% of revenue. This was up from prior year's quarterly EBITDA of $5.1 million and represented the same percentage of revenue. Along with our revenue upside flowing through to earnings, we had positive variances versus our plans related to favorable headcount costs, and some timing shifts on expenses.

Turning briefly to our balance sheet, we ended the quarter with approximately $447 million in cash, cash equivalents and investments, and we had no debt.

Zillow ended the first quarter of 2014 with nearly 900 full-time employees, up from nearly 650 a year ago, and we continue to grow in support of our strategic priorities, which are growing our audience, increasing the size of our Premier Agent marketplace, and developing our advancing marketplaces.

Now turning to our Outlook for the second quarter 2014 and the full fiscal year:

Our revenue for the second quarter of 2014 is expected to be in the range of $75.5 million to $76.5 million. This outlook represents 62% year over year growth at the midpoint of the range.

For our second quarter outlook on EBITDA, we expect a range of $6.0 million to $6.5 million. At the midpoint of our range, this represents approximately an 8% margin.

Also for the quarter we expect depreciation and amortization in the range of $8 million to $9 million, and share-based compensation in the range of $7 million to $8 million.

Although we are not providing a GAAP EPS outlook for the second quarter, we expect a basic and diluted weighted average share count of approximately 40 and 43 million shares, respectively.

As Spencer mentioned, we are raising our full year 2014 revenue and EBITDA outlook. Based on performance to date, we now expect revenue to be in the range of approximately $304 to $308 million, representing an increase of $15 million at the midpoint of the range. And we expect EBITDA to be in the range of approximately $48 million to $50 million, representing a $10 million increase at the midpoint. We remain committed to investing in advertising across multiple channels, and we also plan on ramping our investments in product development as we pursue our strategic priorities. As you know, we run Zillow with a focus on long-term value creation, and as such we might modify our spending strategies as we identify opportunities to better serve our consumers.

Moving quickly to reconciling items to EBITDA for the year, we expect depreciation and amortization to be in the range of $36 million to $39 million, share-based compensation in the range of $28 million to $30 million, and CapEx and capitalized purchased data content in the range of $19 million to $21 million. We expect full year 2014 basic and diluted share counts to be approximately 40.5 million and 43.5 million weighted average shares outstanding, respectively.

In summary, Zillow had a terrific first quarter. We remain focused on accelerating our growth and advancing our home-related marketplaces, and we are extremely excited about our potential in 2014 and beyond.

With that we'll open it up for questions from those dialed into the call, and to questions submitted via Twitter and Facebook with the hashtag #ZEarnings.

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[i] Zillow Internal Tracking, February 2014.
[ii] U.S. Census Bureau, March 2014; National Association of REALTORS®, March 2014.
[iii] Internal calculations; U.S. Census Bureau, March 2014; National Association of REALTORS®, March 2014; Real Trends.
[iv] Internal calculations; Borrell Associates 2013 Real Estate Outlook, September 2013.
[v] IBIS World Inc., 2012 and 2013.